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IN THE

Supreme Court of the United States

OCTOBER TERM, 1957.

No. 277

FRANCES E. LATENDRESSE,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

REPLY BRIEF.

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We think the respondent's arguments to be either misleading or at least confused and confusing. He cites two cases principally. One is *Helvering* v. *Enright*, 312 U. S. 636, and the other is *Cotlow* v. *Commissioner*, 228 F. 2d 186 (C. A. 2d). We find no earthly reason for the gratuitous interjection of this latter case by the lower courts and by respondent. This case stands for the principle that the disposition of an asset other than by sale or exchange prevents the use of the fifty per cent (50%) deduction for a long term capital gain in determining net taxable income (and presumably the alternate tax). Petitioner never did claim a long term capital gains deduction on the basis of the facts found here by the courts below. This case com-

pletely begs the issue before the Court. The sole issue before the courts is whether in determining gain to petitioner she may subtract the decedent's cost basis or whether she uses the fair market value determined as of the date of death of her decedent husband. The *Cotlow* case in no way mentions section 126, or the basis statutes, and does not deny to Mr. Cotlow the right to sell or exchange the assets involved to make use of the long term capital gains deduction. In fact we think this case involves an asset which is typically the subject matter of section 22(b)(3) which exempts the difference between the decedent's cost basis and the fair market value at date of death.

The case of *Helvering v. Enright, supra* (312 U. S. 636), is used in a manner equally misdirecting although it is closer to the point. The *Enright* case is probably the sole source of section 126. Certainly the lower courts tried mightily to squeeze the facts of this *Latendresse* case into the framework of the *Enright* case. And we might agree with respondent that our case is controlled by the *Enright* case except for one slight detail—the cost basis. It would seem rather late in the history of tax law to have to explain that under the Internal Revenue Code the tax law as developed within the framework of the Constitution divides gross income into two major types. The one is derived from earnings and the other is derived from capital transactions. The essential difference is that the acquisition of an asset by earnings is a taxable transaction. The acquisition of an asset in a capital transaction is not a taxable event—any gain is only recognized when the transaction is closed. The *Enright* case gives a fine coverage of the variations of earnings to be included as gross income in respect of a decedent within the meaning of section 126. Unfortunately for respondent (and probably ourselves) the Supreme Court in the *Enright* case spe-

cifically eliminated capital transactions from its consideration in footnote 23, page 645. The existence of the cost basis marks this *Latendresse* case as involving a capital transaction.

Now we are quite certain that a cash basis decedent may bring a capital transaction gain within the spirit of section 126 by simply dying between the closing date and the cash payment date. But, let us face the issue now before the Court. Here the lower courts found no closing during the lifetime of the decedent. This Court must now decide if it is to stand by its old definition of gain from a capital transaction or whether some new unrecognized definition has been created by the enactment of section 126. As we have pointed out in principal brief, the Commissioner of Internal Revenue has succeeded in both this *Latendresse* case and in *Commissioner v. Linde*, 213 F. 2d 1 (C. A. 9th), in eliminating the requirement that a capital transaction must be closed before gain is to be recognized. As we pointed out, the substituted requirements are without substance, merit or foundation.

There is a certain humor here, if one likes humor of a technical nature. The Tax Court must have had an hilarious session trying to decide what to do with the cost basis in terms of the Internal Revenue Code as a technical matter. For instance the hearing Judge who dissented would have brought the facts of the case squarely within the *Enright* case by eliminating the cost basis. His grounds were failure of proof, even though the costs, the values, and the payments were stipulated and stipulated in detail. Further, you will note, the cost basis has two parts, aside from all the money expended in the operation of the business. One part of the decedent's cost basis is outright purchase of his ex-partners' interest in the renewal commissions themselves and secondly, part of the cost basis derives from the purchase of the power to do business in

the first place. If one is tempted to hold death as being the closing of the capital transaction instead of discharge of the obligations or some other disposition such as sale or exchange, then this latter cost basis is technically a capital loss because under the facts as found by the lower courts the decedent's right to do business was terminated by death. The Tax Court did not dare spell this out in detail because the capital loss deduction is not permitted under the terms of section 126. But the Constitution demands that cost basis be eliminated from gross receipts in order to determine gross income, so the Tax Court performed "equity" and lumped the two elements of basis as an offset. This is still not the end of the matter. The Tax Court having determined that the cost basis should be an offset, did so without the citation of statutory authority. The statutory authority is section 113(a) of the Internal Revenue Code of 1939. If the Tax Court had mentioned section 113(a) it would have had to answer petitioner's argument that section 113(a)(5) applies. The easiest way out of this dilemma still appears to us to be that section 22(b)(3) applies to exempt the difference between the decedent's cost basis under section 113(a) and the date of death value of section 113(a)(5) and so eliminates the assets here in consideration from the operation of section 126. Respondent appears to see this and therefore argues for the virtual elimination of section 22(b)(3) and section 113(a)(5) from the Internal Revenue Code. He finds no assistance from case law, legislative history or other sources. He specifically contends that *Hartley v. Commissioner*, 295 U. S. 216, is outmoded and should not be followed.

In conclusion, it seems hardly necessary to warn the Court that the statements of fact are slanted. We believe the prejudicial findings and omissions are all too patent. For instance the lower courts seem to refer to the con-

tracts in question as negotiable property in and as of themselves instead of evidence of the relationship of all the parties involved. As an example of omission all we can say is who in his right mind would suffer all the cost basis investments found here as well as expand all the money called for in these contracts for the operation of this business if he were not doing something more than throwing himself at the mercy of the vagaries of an employee-employer relationship, or even an ordinary agency relationship? Having found the cost basis the lower courts should have spelled out the entire capital transaction. It is now sufficient for our purposes that they found no closing during the decedent's lifetime. But to be charitable to the courts below this is one of those cases where the legal conclusions must be known before we can sort out the pertinent facts from the mass of written papers and documents which were the only evidence left from the decedent's lifetime operations. And, as we set forth in principal brief, this Court is the country's only recourse to the determination of that legal conclusion.

Nothing else in respondent's brief is particularly pertinent or helpful.

Respectfully submitted,

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